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FOR A/OPR/ALS RPASCHALL and ATHURMAN

E.O. 12958: N/A
TAGS: ALOW AMGT AFIN ABUD CG
SUBJECT: Request for Exemption from Local Exchange Rate Adjustments to COLA

REF: 07 Kinshasa 1422

04 Kinshasa 1952

¶1. This is an action cable. Please see para. 9.

¶2. Summary: The DRC economy is very "dollarized." Shopkeepers expect to be paid in dollars, post most prices in Congolese francs, and factor francs/dollar exchange rate increases immediately into those prices. This practice effectively eliminates any exchange rate gains. Most goods are imported from distant markets using foreign exchange and requiring high transport costs. That foreign exchange (euros purchased with dollars) costs nearly 25 percent more than it did 18 months ago. Inflation, exchange rate, and transportation costs have pushed prices higher over the last quarter and there is no end in sight. Post requests immediate waiver of Post Allowance adjustment tied to exchange rate fluctuations. End Summary.

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A "Dollarized" Economy
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¶3. (U) The DRC economy, especially in Kinshasa and other provincial capitals, is almost completely, although unofficially, dollarized. The Congolese franc (FC), currently trading at around FC 550 to the USD, is a non-convertible currency outside of the DRC. In some border areas, such as northeast Congo on the Ugandan border, even foreign currencies besides the USD are preferred to the FC. The largest denomination, now worth well less than a dollar, is the 500 franc note. Embassy personnel, other expatriates, and even many Congolese deal exclusively in dollars, except for small purchases and gratuities. Post has determined that less than 10 percent of exchanges at the Embassy cashier are for francs, and even then for small amounts. Most personnel receive enough francs in change (shops in Kinshasa don't deal in one dollar notes) to satisfy their needs for small bills.

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Store Prices Keep Pace with Exchange Rate Increases
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¶4. (U) Shops that cater to expatriate and well-to-do Congolese shoppers, of which there are dozens in Kinshasa, display their items in either USD or FC. Large ticket items tend to be priced in dollars. Shopkeepers use the following system in order to keep up with both exchange rate fluctuation and double-digit inflation: Instead of price tags on individual items, a sticker with a code (e.g. B2) is displayed on the shelf underneath the items. Nearby, in every aisle, is a pricelist photocopy that links the code to a price in FC. Shoppers must make the calculation back into USD. Store owners are thus able to change prices throughout the store (there are only a couple hundred codes) at will, depending upon the movement of the exchange rate and recent inflation. There is virtually no lag time between an exchange rate change and the accompanying price change on the shelves, based upon the original

cost of the item in USD (known to the owner) and the current FC/USD rate. Prices in FC are never adjusted downward, only upward. Cashiers use hand-held calculators to convert the FC total into a USD price.

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Even "Local Products" are Imported Long Distances
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¶5. (U) Much of what post personnel purchase regularly for their households comes from these local stores. Virtually every item in these stores is imported from Europe or South Africa. They are purchased either in euros (EUR) or rand (ZAR), which are obtained initially using USD (ref A). Even so-called local products, such as eggs and bread, are produced using imported materials, such as chicken feed and flour (imported directly or ground locally from imported wheat). Shopkeepers know the cost of their goods in dollars, including large transport costs for importing the items (perishables by air from Johannesburg, Brussels, Paris, etc.; non-perishables by sea to Matadi, the most expensive port on a per-ton basis in the world). When the exchange rate rises (the FC depreciates) or inflation is particularly high, they merely raise the prices in FC to meet the new macroeconomic situation. This is done to recuperate their costs, maintain their profit margin, and prepare to pay the rising costs necessary to restock their shelves.

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Dollar to Euro Exchange Rate Rules
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¶6. (U) The FC/USD rate, therefore, is irrelevant to post personnel cost of living except for how a store prices an item, based upon its dollar value. What is relevant, however, is the USD/EUR exchange rate, since the majority of the items for sale in local stores come from European sources. (Note: South African goods such as wine are

available for sale, but the ZAR/USD rate has remained stable at around 7.0 for at least the past year. End note.) Since April 2006, when the prior local exchange rate adjustment waiver was rescinded, the USD/EUR rate has risen (the dollar has depreciated against the euro) from about 1.20 to nearly 1.50, almost a 25 percent decrease in buying power. Coupled with annual double digit inflation in the DRC over the last few years, the cost of purchasing food and other household necessities in Kinshasa has gone up appreciably since 4/06.

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U.S. Chicken 25 Percent More Expensive Since October
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¶7. (U) A very recent example from Econcouns firsthand experience: a local food wholesaler sells frozen U.S. chicken leg quarters in 20 kilo boxes. As recently as October 2007, these sold for FC 10,000 (USD 20). As of February, only three months later, the same box is now selling for over FC 14,000 (over USD 25). This 25 percent increase (in dollar terms) over three months is due to three factors: to cover exchange rate increases (FC 500/USD to FC 550/USD), rising inflation in the DRC (over 5 percent since November 1, 2007) and higher transportation costs (air, sea, and land) occasioned by higher international fuel prices. This example could be repeated for any number of food and household items, all purchased wholesale and imported using USD, EUR, and ZAR.

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FC/USD Rate and Prices Go Up
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¶8. (U) As in October 2004, when the last local exchange rate adjustment waiver was requested and granted (ref B), local prices are increasing due to FC depreciation (higher FC/USD exchange rates), monthly inflation equal to annual inflation in the U.S., and higher transportation costs attached to products imported from long distances. We fully expect that if this trend continues, the rising FC/USD exchange rate, despite being largely the basis for higher prices in stores, could actually trigger a reduction in Post Allowance. Due to the ongoing uncertain security in eastern Congo, the continuing high price of fuel and transport, and the unstable

macroeconomic situation (Note: the IMF has backed off on its earlier plan to reinstate a formal program for the DRC, due to recent macroeconomic instability. End note.) post does not expect the Congolese economy to improve dramatically in the near future.

¶9. (U) ACTION REQUEST: Based upon the considered expectation that the USD will continue to strengthen against the FC and that dollar denominated import prices (in turn based upon an ever-worsening USD/EUR exchange rate) will be reflected in local retail pricing, post requests a waiver from automatic Post Allowance adjustments based upon local exchange rate fluctuations. Post understands that such an exemption will require that an annual Retail Price Survey be conducted for the duration of the waiver.

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